

# Washington Beer and Wine Wholesalers Association

P.O. Box 1319  
Olympia, WA 98507  
(360) 352-5252  
Fax: (360) 943-9784  
E-Mail: phil@wbwwa.com

## FAX TRANSMISSION COVER SHEET

**Date:** March 19, 2003  
**To:** Bob Stevens and Jim Stephanson  
**Fax:**  
**Re:** Wine Sales Research Project @ Liquor Board  
**Sender:** Phillip H. Wayt

**YOU SHOULD RECEIVE 9 PAGE(S), INCLUDING THIS COVER SHEET.  
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You may recall from last years' WBWWA Summer General Membership Meeting that we had urged the Liquor Board to research the issue of their being in the wine business, and thereafter, if they are to continue in the wine business, develop a specific five-year strategy for pricing, etc.

Now therefore, they are beginning such a review. They have hired Paul Gregutt you writes weekly for the Seattle Times and has done considerable wine and business research, to conduct the study. I attended a briefing on this yesterday at the Board. Steve Burnell, the Board's Wine Program Manager to head up staffing the review.

Paul is to interview 11 stakeholders which include Steve Burns, officials from Stimson Lane, myself and both of you (Bob Stevens and Jim Stephanson) and others in the industry, including Doug Henken from the Washington Food Industry. This is to be completed with a full report to the Board by June.



WBW-08452

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You'll recall that I submitted both of your names some time ago.

With this transmission is a copy of the study objectives, etc.

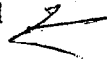
When Paul calls you, I urge you to take the time necessary to meet with him. Please keep in mind the concerns of all our members in this area.

At yesterday's Board meeting, when ask for any comments, I did say I hoped the program review answers the basic question, should the Board be in the wine business at all. I still have that question come up very often from our members. Usually, they say something like, "Wine is about 11% of Board sales, but takes up 40% of shelf space." Therefore, I hope they answer this question once and for all.

For your review prior to your interview, I have included several items.

#1 - Two price comparison surveys recently completed by our members.

#2 - A letter to Liquor Board Chairman Merritt Long from Bob Stevens in July last year, expressing Bob's view on the subject.

#3 - Part of a memo dated June 21, 2000 from Kevin Weatherill, then vice president of Marketing for Brown and Cole Stores to Bob Broderick with AG. This was part of the discussion at the Board's Retail Task Force. As always, we have to carefully watch what the retailers say and exactly how they say it. Notice their comments which I underlined. 

At one point in the 2001 Legislative Session, WFI (Washington Food Industry) had a bill introduced which said the Liquor Board shall use the following formula for products sold in their stores: "The retail sales price of beer and wine products sold in state stores should have an average wholesale product price posted for the private sector filed under RCW 66.28.180 (price posting law), plus a statewide average retail price markup of twenty-five percent for both malt beverages and wine."

That bill never went anywhere. They also had a budget request in the budget, calling for a Liquor Board study on wine pricing. That was never officially adopted.

For the record, our Association stated position on the retailers quest for price parity, "is we support our customers, the retailers."

After you are interviewed by Paul Gregutt, please let me know how it went.

Thanks for your help on this project.

WBW-08453

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**LIQUOR CONTROL BOARD  
WINE PROGRAM STRATEGY  
2003**

**Purpose:**

To achieve the Liquor Control Board's strategic plan goal of providing excellent customer service to our customers through the WSLCB Wine Program. This process will employ the consulting services of a respected wine professional to assist the Wine Program Manager and Purchasing Services division to develop a five-year strategy for the Wine Program. Improvements to the current program will be developed in partnership with the consultant and key stakeholders, which then will be recommended to the Board.

**Objectives:**

1. Update the wine program strategy. This will include a 5 year strategy.
2. The recommendations from this strategy will focus on the following goals of the agency's strategic plan and retail business plan.
  - Maximize revenues to the state's taxpayers
  - Streamline and create effective business practices
  - Strengthen partnerships with customers, stakeholders and communities
  - Consider a new merchandising and display program for wine

**Areas of focus:**

- Current market trends for wine nationally and in Washington state
- Current market retail trends both nationally and in Washington
- Stakeholder Interviews
- Training and Recognition
- Retail Price
- Distribution, merchandising and displays
- Partnerships to assist Washington producers and suppliers
- Economic Vitality to the State of Washington

WBW-08454

WBW\_107267

# Western Washington Beverage

a division of Alaska Distributors Co.

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Seattle, Washington 98108

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RECEIVED  
JUL 29 2002  
BOARD MEMBERS

cc: Vera  
Roger  
Pat  
Rick

July 25, 2002

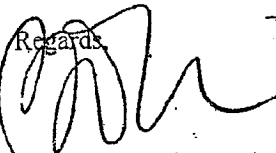
Merritt Long, Chairman  
Washington State Liquor Control Board  
PO Box 43076  
Olympia, WA 98504-3076

Dear Chairman Long:

It was a pleasure to spend time with you and your team in Chelan. I was really sincere in my remarks about the refreshing approach you are taking toward improving the way in which the State conducts its liquor business.

On the subject of wine pricing, as I mentioned during our brief conversation at lunch, I have studied the issue for many years and I am convinced that the problem is caused, not by the Liquor Control Board but, by those suppliers and wineries who elect to charge the Board "distributor" prices as opposed to "wholesale" prices. Most wine items on State store shelves are currently competitive but not substantially below the private sector. It is only when a winery wishes to achieve a much lower shelf price that large "spreads" occur. Changing the State's wine markup structure would not correct that problem. It must be corrected by the people who ultimately decide what a product is going to sell for: the manufacturers. It is certainly within the power of the grocery industry to contact these "offending wineries" and encourage them to charge the Board prices that are closer to those being charged by wholesalers in the private sector.

I would be happy to discuss this issue with you and your staff at any time.

Regards,  
  
Rob Stevens

WBW-08455

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TX180\_004

PHIL SURVEY AS REQUESTED

BRAND/ITEM	STATE	SAFEWAY
ALICE WHITE CHARD 1.5	799	1199
FRANZIA RHINE 5.0	849	998
COOKS BRUT 750	370	498
FARRON RIDGE WHITE 1.5	606	799
FRANZIA CHILL RED 5.0	849	998
" W. GRENACHE 5.0	849	1249
BERINGER W. ZINF 750	499	599
COLUMBIA WOODBURN CA 750	499	1099
GSM JR 750	548	549
COL. CREST CHARD 750	698	798
COLUMBIA REISL 750	485	739
PAUL THOMAS CHARD 750	499	799
HOGUE DRY WH 1.5	619	899
GSM CHARD 750	882	1098
COVEY RUN REISL 750	499	649
HOGUE BL.D BL 1.5	629	899

GOODS LUCK.

J.M

From Mary

WBW-08456

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TX180\_005

COSI ANALYSES - Walla Walla, WA.

①

state-run store		Safeway #1160
Alice white chardonnay 1.5L	N/A	11.49
Franzia blush SL	8.49	9.98
Vendange Chardonnay 1.5L	N/A	8.49
Franzia Chablis SL	9.49	11.99
R. Mondavi Woodbridge chard 1.5L	N/A	11.98
Franzia rhine SL	8.49	9.98
Kendall-Jackson chardonnay 750ml	14.75	10.99
COOKS brut 750 ml	3.70	4.50
Corbett Canyon chardonnay 750ml	N/A	N/A
Franzia Silverbirch SL	8.49	9.98
Sutter Home white Zin. 1.5L	7.95	7.49
Columbia Woodburn chard 750ml	N/A	10.49
Glen Ellen chard 1.5L	N/A	9.98
Farm Ridge white 1.5L	6.00	7.69
Franzia Chili Red SL	8.49	9.98
Franzia wht. Grenache SL	9.49	12.49
Beringer wht. Zinfandel 750ml	A.99	5.79

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(Cost Analysis) Cont'd Walla Walla

(2)

State - Ron Store		Safeway #1160
St. Michelle Jo. Riesling 750ml	5.48	5.98
Columbia Crest chardonnay 750ml	6.98	7.98
Farran Ridge Red 1.5L	6.06	7.69
Columbia Riesling 750ml	5.99	7.99
Paul Thomas Chardonnay 750ml	4.99	8.29
Columbia Crest Cab. Sauv. 750ml	6.98	7.98
Hogue harvest dry white 1.5L	6.29	8.99
St. Michelle chardonnay 750ml	8.82	9.99
Hogue harvest white 1.5L	6.29	8.99
St. Michelle Gewurztraminer 750ml	5.48	5.98
Corey Run Riesling 750ml	4.99	5.99
Hogue harvest blanc de blanc 1.5L	6.29	N/A

WBW-08458

WBW\_107271

TX180\_007

FROM Kervin Weatherill - Brown & Cole  
TO Bob Broderick 6/21/2000

fund? If state sales tax were included - privatization would not necessarily reduce tax revenue. If privatized the liquor tax revenue source would merely be shifted to private industry from state operated stores.

- On page 87 of the Operations Report there is a graphic that depicts the layers of costs added to a purchase of liquor. Are the taxation levels the same for Beer & Wine?

### Concerns Regarding The States Advantage Over Private Sector for Beer & Wine Sales

The State imposes payment rules on the private sector but enjoys the benefit of not abiding by them.

As I understand it, the State manages their liquor inventory, (including wine?), under a system of bailment at from distribution center. Meaning that the vendor owns the inventory that is in the State's distribution center. At the first of the month and at mid month purchase orders for product ordered by the State's stores are cut and sent to the manufacturer with 30-day payment terms. I don't know if there are early payment terms like 2/10 net 30.

In contrast, state regulations require the retailer to make payment upon delivery for all liquor items. This is the only product classification in our business where this is required. Cash flow is everything to a business. This payment rule is an unfair burden on private retailers - particularly the small family owned business.

Rules for product returns and inter store transfers are burdensome for the retailer. Liquor is the only product classification subject to such stringent limiting rules. If a vendor over ships product and it is not quickly caught - the retailer must deal with the excess product with no support from the distributor. Since the distributor receives cash upon delivery, limiting risk, they often deliver excess product. Given that returns and transfer of product is so cumbersome - the retailer is often impacted with large reserves of product on their shelves and in their backrooms.

The fact that private sector liquor payment terms are unfavorable to the retailer - excess inventories further exacerbates retailer cash flow impacts. Something we know the state is not faced with as it competes with the private sector for beer & wine sales. (I know that the State has limited selection of beer at this point in time. However, I know of nothing on record to prohibit the State for growing their retail presence in beer just as they have in wine over the past few years.)

### Concerns regarding the States Practice of Predatory Pricing for Wine

Factors that underscore the predatory pricing argument;

- The LCB has regulations that stipulate that wine and beer cannot be sold below acquisition cost.
- The LCB publishes their pricing monthly & they offer a discount of 10% off their published prices for full case purchases.
- On page 68 of the LCB's 65<sup>th</sup> Report of Operations their markup and sales tax targets are outlined.
  - Wine Markup on Delivered Costs 35%\*\* (\*\*Varies, but averages approximately 35%)
  - Average Margin on Sales (Including State Liquor Taxes) 24%
  - The page leaves it a bit unclear Markup refers to the profit based on cost, while gross margin refers to the profit based on the selling price. In this case a 35% markup on cost would yield about a 26% gross margin on selling price.
  - Washington State private sector wine margins range from 20% to 30%.



With the help of Bob Broderick, we put together a list of wine to compare pricing between supermarkets and the LCB – using the official price list. As the basis for the list – we used standard market share data for Seattle from the IRI and Nielson companies. These companies buy supermarket scan data to log item level market share of consumer goods. We compiled the list of wine from market driven information – starting with the number 1 wine item in the market on down.

Using current wholesale costs for the Seattle market and the LCB's current retail pricing we created an analysis that shows what private retailer margins would be on the best selling items in the market if we sold them for the same price as the state. (Data for costs and retail were taken from the same month for the LCB's official price list and wholesaler posted costs.) See attached Spread sheet:

As you can see – if a private wine retailer matched the LCB's retail price on the best selling items in the market – margins would fall well below traditional supermarket targets and well below the States average margin of 25%.

In fact if a private retailer applied the States 10% full case discount to some of the items – they may violate the law by selling below their cost.

Any way you look at it – something is unfair about the States pricing for wine versus private retailers – especially when you take into account payment terms. What cash upfront business could last selling at such low margins without float on their inventory? In this case it appears that the State has the best of both worlds.

One note with regard to the State's lower retail pricing – the current pricing practices of the LCB in addition to being predatory and unfair – also derives lower levels of sales tax revenue versus the private sector wine sales on the basis of the LCB's lower retail prices.

### Concerns Regarding Deloitte Touche's Recommendations & LCB Draft Plan

Given that the LCB competes for business with the private sector, I am a bit apprehensive with regard to Deloitte's endorsement of improving their ability to compete with state of the art retail business and data systems. Private businesses continually struggle with formulation of capital to reinvest in their infrastructure.

For instance, my company has retail sales of over \$400 million per year. We are the second largest privately held supermarket chain in the state. If we were a monopoly, secure and safe capital allocation decisions would be a snap. Unfortunately we are not a monopoly and we are face with new stores, competitor attacks for market share etc. Capital decisions must compete among such issues as new growth, reinvestment in current facilities, reinvestment in corporate systems and infrastructure. A data mart EIS business system has been on the project boards for my company for several years now. But because of competing projects and competitive pressures, not to mention the large capital outlay, we have yet to break the initiative.

The LCB Draft Plan suggests that they want to begin to act more like a private business than they do today. The current method of funding through legislative allocation restricts the LCB's ability to respond to opportunities to improve their business. In my opinion, allowing the LCB to initiate projects driven toward improving their operations represents an increasing competitive threat to private sector retailers. As long as the LCB operates as a self regulated monopoly – the private sector's only protection is to streamline their operations to function at levels rather than gear towards state of the art support systems.

Also, the LCB Draft Plan points out their desire to improve their services for the state's consumers. To support this initiative in addition to improved business systems – the need for improved staffing